

Budget Law 2021: tax incentive for business combinations

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Introduction

Parliament recently enacted the Budget Law 2021 which, among other things, enables a portion of deferred tax assets (DTAs) to be converted into a tax credit relating to tax losses carried forward and excess aid to economic growth (ACE), accrued up to the fiscal year prior to that in which a business combination occurs.

Under the new rule, the convertible DTAs need not be recorded in the company's financial statements. Further, the total amount of DTAs to be converted into a tax credit cannot exceed 2% of the assets of the entities participating in the business combination.

Relevant business combinations

The relief applies to selected business combinations via mergers, demergers and contributions of going concern implemented in 2021. The entities involved in such a business combination may benefit from the relief only once.

The new provision may also be applied to business combinations resulting from acquisitions (shareholding acquisitions or shareholding combinations) if the acquisition is followed, within one year, by a merger, demerger or contribution of going concern.

The rule aims to encourage business combinations and more structured and competitive realities on the market, especially in a crisis situation, such as that brought about by the COVID-19 pandemic. Thus, the benefit does not apply to companies for which a state of dissolution or insolvency has been established.

Eligible entities

Subsidiary companies, parent companies and companies under common control are excluded from the relief.

In particular, the new rule provides that the relief applies to entities which have been operating for at least two years and which, on the date of the transaction or in the two years prior, are not or have not been part of the same group.

In addition, the entities must not be linked to each other by shareholdings higher than 20% or controlled, even indirectly, by the same person pursuant to Article 2359, Paragraph 1, Number 1 of the Civil Code.

Beneficial regime

The conversion of DTAs into a tax credit is not free of charge. Rather, the conversion will take effect on the payment of a fee equal to 25% of the DTAs (such fee is deductible for national corporation tax (IRES) and regional corporation tax (IRAP) purposes). The payment of tax-deductible fees is divided into two instalments:

- The first (equal to 40%) must be paid within 30 days of the legal effectiveness of the business combination.
- The second (equal to 60%) must be paid within the first 30 days of the following fiscal year.

The benefit can be summarised as follows: for each €100 of losses carried forward, for example, the DTAs are equal to 24 (IRES tax rate) and the fee due is equal to six (25% of 24). The final outcome of the conversion of

AUTHORS

[Simona Zangrandi](#)



[Franco Pozzi](#)



the DTAs is that 18% of the amount of the previous tax losses becomes a tax credit.

Operational aspects

The conversion of DTAs into a tax credit takes place in two stages:

- One-quarter of the DTAs may be converted into a tax credit as from the date on which the business combination occurs.
- Three-quarters of the DTAs may be converted into a tax credit on the first day of the following fiscal year.

The tax credit may be used for offsetting purposes (eg, income or wage withholding taxes), with no limit on the amount, or it may be transferred or refunded. In any case, it is not a taxable amount for IRES or IRAP purposes.

As from as the date on which the business combination occurs, the losses carried forward and the ACE surpluses that gave rise to the conversion of the advance taxes into credits can no longer be used in order to reduce the taxable base of the entity resulting from the business combination.⁽¹⁾

Should the merger occur (ie, registration of the last deed by the competent Trade Register) in 2021, the three-quarters of the deferred tax credit will be available from 2022.

For further information on this topic please contact [Simona Zangrandi](#) or [Franco Pozzi](#) at Studio Legale Tributario Biscozzi Nobili Piazza by telephone (+39 02 763 6931) or email (simona.zangrandi@slta.it or franco.pozzi@slta.it). The Studio Legale Tributario Biscozzi Nobili Piazza website can be accessed at www.sbnp.it.

Endnotes

(1) In the case of mergers and demergers, the losses and ACE surpluses originating from both parties (transferor and transferee) involved in the business combination are relevant; in the case of a contribution of going concern, only the components accrued to the transferee party are relevant.

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